MEMORANDUM FOR THE RECORD

TO: File
FROM: Donna Norman
DATE: February 27, 2010
RE: February 9, 2010 Meeting With SEC OCIE re: Citigroup

FCIC Staff present: Brad Bondi, Donna Norman

SEC Staff present: Sam Forstein, Tim McGarey, Mary Ann Gadziala, Mavis Kelly; Bob Sollazzo, Suzanne McGovern, Kris Easter

This is a paraphrasing of the interview dialogue and is not a transcript of the meeting and should not be quoted except where clearly indicated as such.

The Office of Compliance Inspections and Examinations looks at I-Banks like Citi through two lenses, the BD lens and the Investment Advisor lens. We spoke to both BD and IA teams.

The SEC is in the process of finalizing an examination into Citi (CGMI), which is the registered BD entity. Notably, there are no risk management or safety and soundness rules, per se for BDs. During these exams OCIE looks for general risk management weaknesses. OCIE looks at internal audit, among other areas, and is specifically looking for the following potential classes of risk: credit; market; legal and compliance; and liquidity and funding. In another Citi exam, OCIE did not see anything "earth shattering", but it did note that Citi exams are challenging because of the disparate structure at Citi. Additionally, it likely will note weaknesses in the risk management practices at Citi.

OCIE completed its last BD risk management exam of Citi in June 2006. The work for the exam was performed the prior year in 2005 and the exam was conducted jointly with the NYSE, DC and NY OCIE and the SEC Division of Market Regulation. That exam focused in part on on Citi's options and mortgage products business and some concerns that Citi's valuation/risk models had not been approved by the Fed.

OCIE noted that we may find useful information in Citi's BD SEC "Appendix E" filings, which require discussion of registered firms' VaR and valuation models. Appendix E also requires firms to submit organizational charts. Sollazzo recalled that in the 2005-06 timeframe Citi had an issue with sales team members meeting collateral calls through repricing. Sollazzo noted that this was questionable behavior. Sollazzo noted that a subsequent sweep exam conducted in 2007 indicated that Citi was among the weaker firms on internal pricing and valuation controls. OCIE also noted that Citi frequently allowed traders to exceed their credit risks and did not consistently follow its internal escalation procedures to extend limits.

In June/July 2007, OCIE and FINRA conducted a coordinated sweep of 10-12 major institutions (including Citi) relating to their respective subprime businesses. The sweep focused on valuation and collateral management risks. The sweep resulted in a deficiency report and letter to Citi and a response from Citi. FINRA's Risk Oversight and Operational Regulation (ROOR) group, headed by Grace Vogel, took the lead. FINRA has agreed to arrange an interview with Grace Vogel and hopes to locate the report, deficiency letter and Citi response for us shortly.

The primary focus of the sweep, *vis a vis* Citi, was the firm's ability to independently value securities (including CDOs, AAA senior tranches). The Sweep found the "Independent Control Group" was not really doing any independent price versification of the trading desk. This became a huge issue when the market froze and there were no market observables to set the price. Firms other than Citi used models based on the ABX. Citi basically deferred to its traders.

Citi is on OCIE's "Compliance Monitoring List" and makes quarterly briefings to the Fed, OCC and SEC. During the time that Citi was a voluntary reporter under the Consolidated Entity Program, Citi also made periodic additional reports to the SEC Division of Market Regulation. During one such presentation in June 2007 Citi addressed valuation methods.

OCIE noted that Citi exams generally always were complicated by Citi's unwieldy structure and the fact that the numerous legacy systems and procedures from firms acquired were never fully integrated into an organization with a single vision.
In late 2007-08, OCIE cited Citi for a number of control weaknesses relating to failing to supervise its sales practices. In the last several years, OCIE has done a number of additional cause exams arising from complaints about Citi's registered reps. None appeared relevant to our inquiry.

The OCIE Investment Advisor program conducted a routine exam of the Citi complex in 2007. OCIE noted the related Citi exams generally resulted in some variant of deficiency letter for control weaknesses and lack of proper documentation for valuation and pricing disputes.

OCIE agreed to put together a list of good risk management practices that we can tee up to Citi personnel as comparables. OCIE also suggested that the pricing service J.J. Kenny might be a good resource. JJ Kenny appears to be a Standard & Poor's service.